No. 82-248

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CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1981

JOHN H. NORBERG, AS TAX ADMINISTRATOR
OF THE STATE OF RHODE ISLAND, PETITIONER

v.

GEORGE, INC., RESPONDENT

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ON WRIT OF CERTIORARI TO THE SUPREME
COURT OF THE STATE OF RHODE ISLAND

PETITION

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QUESTIONS PRESENTED

The questions presented for review are:

1. Whether the Rhode Island Supreme Court has so arbitrarily construed the Rhode Island business corporation tax statute as to constitute an encroachment on the legislative function and a deprivation of tax revenues to the executive branch in violation of due process of law as guaranteed by the Fourteenth Amendment of the United States Constitution;

2. Whether the state court so rewriting the tax statute denied the petitioner the equal protection of the laws guaranteed by the Fourteenth Amendment of the United States Constitution.

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OPINIONS AND ORDER DENYING PETITION FOR REHEARING IN COURTS BELOW AND ADMINISTRATIVE DECISION

This case began with an administrative hearing in the Rhode Island Division of Taxation. Decision was made by the Tax Administrator. The decision was affirmed by the Rhode Island District Court of the Sixth Division. The decision was reversed by the Rhode Island Supreme court in its opinion reported in 444 A. 2d. 868 with rehearing denied. Copies of the administrative decision, court opinions and order denying rehearing are set out in the appendix.

STATEMENT OF THE GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED

The judgment of the Rhode Island Supreme Court here sought to be reviewed was entered on April 29, 1982.

Petition for rehearing was denied on May 20, 1982.

Jurisdiction is conferred on this Court with respect to this petition by 28 USC 1257 (3).

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

Reference is made to the following statutes with pertinent extracts set out in the appendix:

U.S. Constitution, XIV Amendment - 1

26 USC sec. 23 (c) (Internal Revenue Code of 1939, sec. 23 (c))

26 USC sec. 31 (Internal Revenue Code of 1939, sec. 31)

26 USC sec. 131 (Internal Revenue Code of 1939, sec. 131)

26 USC sec 164 (a) (3) (Internal Revenue Code of 1954, sec. 164 (a) (3))

26 USC sec 275 (a) (4) (Internal Revenue Code of 1954, sec. 275 (a) (4))

26 USC sec 901 and 902 (Internal Revenue Code of 1954, sec. 901 and 902)

Rhode Island General Laws 44-11-2 (2) (a)

Rhode Island General Laws 44-11-11 (a)

STATEMENT OF THE CASE

Parent, Champlin Jewelry Company and 100% owned subsidiary, George, Inc., were both liable in 1976 for Rhode Island business corporation taxes. George paid $36,573.25 in Canadian taxes and distributed its income to Champlin. George's principal place of business was Rhode Island.

Champlin filed a Rhode Island consolidated return and deducted the foreign tax payment of $36,573.25 paid by George. On audit it was determined, and agreed, that the corporations were not qualified for consolidated return status. The Tax Administrator determined that the foreign tax payment was not deductible on the separate return of George under Rhode Island General Laws 44-11-11 (a). George paid the deficiency, claimed refund, sued and was upheld by the Rhode Island Supreme Court. Certiorari is sought to review that decision.

HOW THE FEDERAL QUESTION IS RAISED

The Federal question is raised by the decision per se

of the state court. The decision in its effect denies to the petitioner the due process and equal protection of the laws guaranteed by the U.S. Constitution, Article XIV - 1. Prior to decision there was no reason to raise questions of Federal constitutionality.

Here there is a substantial and decisive Federal question. Has the construction of the corporate taxing statute of a state been in effect rewritten by the state judiciary so as to constitute an exercise of legislative power and the deprivation of revenue rights of the executive branch of the state government.

The decision lacks due process and denies equal protection of the law and cannot be justified on non-Federal grounds.

ARGUMENT

This case involved the construction of a state corporate tax statute. Review is not sought on a quibble of interpretative language. Rather the decision is so erroneous as to result in the judicial rewriting of a state statute impinging on the prerogatives of the legislative and executive branches of the state government. Such judicial action violates the requirements of due process of law guaranteed by Article XIV.

George, Inc., the respondent here, paid a Canadian tax. George, afforded an option by IRC 901, elected a credit in lieu of a deduction against gross income as allowed by IRC 164 (a) (3), and assigned the credit to an affiliate (Champlin) as allowed by IRC 902. George did not claim a deduction for the Canadian tax paid on its 1976 Federal return. Then, George on its Rhode Island return claimed the foreign tax payment as a deduction against its gross income. The petitioner, Tax Administrator, disallowed the deduction.

The Rhode Island corporate income tax (44-11-11 (a)) begins with Federal gross income (after adjustments) minus "all items deductible under the federal corporation income tax law applicable to the taxable year". When George, Inc. elected to take the credit against tax under sec. 901, the deduction allowable under sec. 164 for such

foreign taxes was no longer "deductible under the federal income tax law applicable to the taxable year" pursuant to the provisions of IRC sec. 275.

Rhode Island G.L. 44-11-2 (2) (a) taxes the George, Inc. class of corporations on the basis [44-11-11 (a)] of "federal gross income . . . minus . . . all items deductible under the federal corporate income tax law applicable to the taxable year". This taxing measure was enacted in 1947.

In 1947, the Federal Internal Revenue Code of 1939 (26 USC 31), and as in force in 1947, provided by sec. 31 for a credit for foreign taxes paid. In the alternative the IRC in force in 1947 (26 USC 23 (c)) provided for a deduction for foreign taxes paid by Sec. 23 (c). Barton: Federal Income, Estate, and Gift Tax Laws Correlated, 10th Ed., pp. 60 - 61, and pp. 144 - 145.

The foreign tax credit (IRC 901) and the deduction for foreign taxes paid (IRC 164 (a) (3)) are not the same. The credit reduces the tax dollar for dollar, while deductions merely reduce taxable income.

There is a further significant difference. The IRC 164 deduction leaves the resultant tax savings with the corporation which paid the foreign tax. Not necessarily so with the credit. IRC 902 allows a passing of the credit to another corporation. On receiving a dividend from a foreign corporation of which it owns 10% or more of the stock, a corporation is deemed to have paid any foreign income taxes allocable to the dividends paid by the corporation paying the foreign tax. These so-called "derivative tax credits" may further involve complicated pass-throughs by second-and third- tier foreign corporations. B.I. Bittker: Federal Taxation of Income, Estates, and Gifts, 69.2.1.

To equate the "deduction" with the "credit" rewrites the 1947 Rhode Island corporate tax statute and creates a burdensome and difficult administrative task in searching the returns of multiple taxpayers to police pass-throughs. Rhode Island legislature did not incorporate the credit. Creating new deductions for dividend recipients in differ-

ent brackets (as a dividend to a loss corporation) with difficult administrative problems by judicial fiat is not due process of law. Instead of relief from double taxation the opportunity for double advantages has been created. As a relief provision 44-11-11 (a) (3) allowing deductions should be construed strictly against the taxpayer.

The foreign tax paid was not deductible by George on its 1976 Federal return. George elected to waive tax relief from double tax on the Canadian tax payment on its return and passed the tax benefit to Champlin by the assignment of a credit for the payment under IRC 902. After such an assignment by George the foreign tax was no longer deductible on the instant return.

The Federal Internal Revenue Code has a specific provision prohibiting a double use of a foreign tax payment. IRC 275 (a) (4) bars a deduction where a credit - subject to pass on to another corporation - has been elected. The Rhode Island statute does not permit a credit and accordingly has no equivalent limitation. The 1939 Internal Revenue Code sec. 23(c) and sec. 131 (26 USC 23(c) and 131) in 1947 barred a double Federal deduction.

The judgment cannot be dismissed as merely an interpretation of a state statute by a state court with finality of decision. Rather the result is so arbitrary and against the fundamentals of statutory construction as to deprive the Tax Administrator of his taxing rights without due process of law.

Consider the possibilities. A Rhode Island corporation elects credit and assigns it to a non-Rhode Island parent. Then, the Rhode Island corporation on its Rhode Island return under the privilege given by this instant decision deducts the foreign tax. Result is a double benefit and a loss of Rhode Island revenue where the parent assigned the credit is outside of Rhode Island.

The opinion of the court further rendered the administration of corporation tax law chaotic by allowing a corporation to claim as deductible more than one aspect of a deduction which is deductible by various methods under the applicable Federal law even though only allowable in filing its Federal return in only one aspect of such deduc-

tion. For example, there are various Federal methods of depreciation. There is no state enumeration of such deductions. Thus, a taxpayer may claim more than one depreciation deduction, since they are all deductible under the Federal law.

The Rhode Island court strayed from its own precepts, as set forth in a number of cases, the most recent of which stated:

> "In construing a statute, this court must give effect to all parts of the statute if reasonably possible".

Rhode Island Chamber of Commerce v. Hackett, -R.I.-, 411 A. 2d. 300, at 303 (1980).

The court paid lip service to that construction by citing sec. 275 in footnote 2, but then proceeded to interpret "deductible" alone to require a finding in favor of taxpayer. This completely ignored the rest of the clause under review.

The Rhode Island court, in the penultimate paragraph of its opinion virtually raised the constitutional questions by disregarding cases from other jurisdictions on the ground that the statutes in those cases differed by requiring "a corporate taxpayer to begin computing state tax liability from its federal taxable income rather than from its gross income".

The court then found inapposite cases from other jurisdictions on the ground that the statutes in those states require a corporation to begin with federal taxable income to compute state taxes. The Rhode Island statute arrives at the same base by computing, from federal gross income minus all items deductible under the federal law applicable to the taxable year, the Rhode Island tax on federal taxable income.

It is therefore submitted that the holding of the Rhode Island court failed to afford the petitioner equal protection under the laws of the United States as incorporated into the Rhode Island statute.

In short, the judiciary has arbitrarily rewritten a taxing statute and encroached on the legislative function so as to deprive the executive branch of the government its

right to revenues in violation of the due process and the equal protection of law as guaranteed by the Fourteenth Amendment.

State tax laws increasingly incorporate IRC provisions. Misinterpretation of the Federal Internal Revenue Code by state courts can adversely affect state revenues. A state tax administrator has no redress unless this Court grants certiorari. This case presents an opportunity to admonish state courts to consider well the complex provisions of the Internal Revenue Code written into state statutes.

The courts fashion the common law to the changing circumstances of society. For many years change has been studied and cautious. But, in recent years courts are making rapid and abrupt changes by judicial action. Cases are sent to juries on new theories of substantive law. Liabilities are created for theoretical acts of negligence not recognized at the time of occurrence. Abrupt change creates legal uncertainties. Here the court has in effect rewritten a statute - the prerogative of the legislature elected by the people. This case offers a timely opportunity for the Court to require the judiciary to approach change with deep reflection and reasonable pause.

Wherefore petitioner asks that a writ of certiorari issue to review the judgment of the Supreme Court of Rhode Island in the above entitled case.

Dated: _____, 1982

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SUPREME COURT OF THE UNITED STATES

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JOHN H. NORBERG, AS TAX ADMINISTRATOR OF THE STATE OF RHODE ISLAND, PETITIONER

v.

GEORGE, INC., RESPONDENT

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF RHODE ISLAND

APPENDIX

1. Copy of opinion in George, Inc. v. John H. Norberg, Tax Administrator, Rhode Island Supreme Court, 444 A. 2d. 868 (R.I. 1982), being decision for which certiorari is sought. *Pages 10-15*

2. Extracts setting out Constitutional provisions and statutes involved. *Pages 15-21*

3. Copies of other opinions, orders, and decisions in the case. *Pages 22-28*

4. Copy of judgment (last paragraph of state court opinion, 444 A. 2d. 868 (R.I. 1982) *Page 28*

444 ATLANTIC REPORTER, 2d SERIES 868

GEORGE, INC.

v.

John H. NORBERG, Tax Administrator.

No. 79-425-M.P.

Supreme Court of Rhode Island.

April 29, 1982.

Additional corporate income tax was assessed. The District Court sustained tax administrator's decision. Certiorari was granted. The Supreme Court, Shea, J., held that taxpayer, which had taken as credit against its federal income tax liability the amount it had paid Canada on income from Canadian holdings, was entitled to deduct

the Canadian tax payment in computing its state income tax liability.

Judgment quashed and papers remanded.

1. Taxation 1088

Although tax administrator is required to resolve questions of law and fact to apply revenue statutes consistently with legislative intent, his determinations of law are not binding on the reviewing court. Gen. Laws 1956, §§ 42-35-16, 44-11-35.

2. Taxation 1088

Review before Supreme Court of validity of additional corporate taxes assessed against taxpayer properly included questions of law involving applicability of governing statute to undisputed facts. Gen. Laws 1956, § 42-35-16.

3. Taxation 1045

When legislature allowed a corporate taxpayer to use gross income, as reported on federal tax return, in computing state corporate tax liability it thereby allowed taxpayer to reassess its deductions against income without reference to the federal return and, thus, in computing 1976 Rhode Island business corporate income tax liability taxpayer properly deducted from gross income the amount it paid Canadian government on on income received from Canadian holdings, notwithstanding that on federal return it took the Canadian tax as a credit and that state law permits a reduction for all items "deductible" under federal law. 26 U.S.C.A. § 164(a)(3); Gen. Laws 1956, § 44-11-11(a)(3).

Gorham & Gorham, John Gorham, Edmund L. Alves, Jr., Providence, for petitioner.

Dennis J. Roberts, II, Atty. Gen., Perry Shatkin, Charles Goldkamp, Div. of Taxation, Providence, for respondent.

OPINION

SHEA, Justice

We granted certiorari in this case to consider the valid-

ity of additional corporate income taxes assessed against the taxpayer, George, Inc. (George). The District Court sustained the tax administrator's decision that required George to pay an additional $2,649.97 plus interest in state income taxes for 1976. We sustain George's petition and quash the judgment below.

George was a Delaware corporation with its principal place of business in Rhode Island.[1] It was a wholly owned subsidiary of a Rhode Island corporation established as a personal holding company for the benefit of its sole stockholder, a Rhode Island resident. George's sole asset consisted of securities held in Canadian corporations.

For the taxable year 1976 George received income from its Canadian holdings and paid a tax of $36,573.25 to the Canadian government. On its United States income tax return George took a credit for foreign taxes paid and reduced its federal corporate tax liability by the full amount of those taxes. The Internal Revenue Code permits a taxpayer either to deduct foreign income taxes from gross income (in the case of a corporation) or to take them as a credit against tax liability. 26 U.S.C.A. § 164(a)(3) (1978), § 901(a) (1967).

In computing its 1976 Rhode Island business corporation income tax, George deducted the Canadian taxes from its gross income. In so doing George relied on the provisions of G.L.1956 (1980 Reenactment) § 44-11-11(a)(3). That section permits a corporate taxpayer to reduce its gross income as reported on its federal return by "all items deductible under the federal corporation income tax law applicable to the taxable year* * *." It thus computed its Rhode Island income tax liability to be $14,924.11.

The tax administrator determined that the foreign taxes were not deductible on George's state return. He assessed a further tax of $2,649.97 plus interest against George. George paid the additional tax and filed for a refund pursuant to § 44-11-20. An administrative-hearing officer upheld the assessment and the District Court sus-

1. George, Inc., has since been liquidated.

tained the decision upon George's appeal under § 44-11-35. We granted certiorari pursuant to G.L.1956 (1977 Reenactment) § 42-35-16.

The sole issue concerns the proper meaning of the word "deductible" contained in § 44-11-11(a)(3). The tax administrator ruled, and the District Court agreed, that George could not deduct the foreign taxes on its state return because it had not elected to deduct these taxes on its federal return. Because George had elected to take a credit against its federal tax liability, the tax administrator ruled that the item was no longer deductible.[2]

The interpretation given to § 44-11-11(a)(3) by both the tax administrator and the District Court would require that the item actually be deducted on the federal return before a taxpayer could also deduct the item on his state return. George argues that the validity of the deduction for state tax purposes should not be dependent upon whether the item was actually deducted on its federal return. It contends that "deductible" clearly means "capable of being deducted," rather than "taken as a deduction." Webster's Third New International Dictionary 589 (1967); *see also* Black's Law Dictionary 372 (5th ed. 1979). When a federal return is being prepared, federal law allows the deduction of foreign taxes. Moreover, George argues, the filing of the return, despite the election of the credit, does not make the foreign taxes any less capable of being deducted. Actually, they remain deductible because a taxpayer who takes a credit for foreign taxes may change his election and file an amended tax return claiming the deduction thereon. 26 U.S.C.A. § 6511(d)(3) (1967). The sense of George's view is that what determines whether or not an item is deductible is the federal law applicable to that particular tax year and not the actual schedule of deductions applicable to that year.

The tax administrator interprets the term "deductible"

2. The regulations found in 26 CFR § 1.901-1 (1981) deny a federal deduction if the taxpayer elects a credit for the same item. *See also* 26 U.S.C.A. § 275(a)(4) (1978).

to mean "taken as a deduction." He reads § 44-11-11(a)(3) as a consideration of what deductions are applicable to the tax year in question and not what the law applicable thereto otherwise permits, regardless of what a taxpayer decides to do. Accordingly the nondeduction of an item on the federal return for a given tax year, according to the tax administrator, would preclude that item from being deductible for purposes of the state corporation income tax.

[1, 2] The tax administrator is required to resolve questions of law and fact to apply revenue statutes consistently with legislative intent. However, his determinations of law are not binding upon the reviewing court. They "may be reviewed to determine what the law is and its applicability to the facts." *Gott v. Norberg*, R.I., 417 A.2d 1352, 1361 (1980) (quoting *Narragansett Wire Co. v. Norberg*, 118 R.I. 596, 607, 376 A.2d 1, 6 (1977)). Review before this court under § 42-35-16 properly includes questions of law involving the applicability of a statute to undisputed facts. *Flather v. Norberg*, 119 R.I. 276, 280 n.2, 377 A.2d 225, 227 n.2 (1977).

The divergence of views between George and the tax administrator demonstrates, and we conclude that § 44-11-11(a)(3) is not so clear as either George or the tax administrator asserts it to be. The opposing arguments each flow reasonably from the words of the section. Consequently, the intent of the Legislature cannot be viewed as settled. However, this court has long adhered to the rule that revenue statutes are to be construed strictly, with doubts about their meaning and scope resolved in favor of the taxpayer and against the taxing authority. *Maggiacomo v. DiVincenzo*, R.I., 410 A.2d 1332 (1980); *Newport Gas Light Co. v. Norberg*, 114 R.I. 696, 338 A.2d 536 (1975); *Manning v. Board of Tax Commissioners of Rhode Island*, 46 R.I. 400, 127 A. 865 (1925)

The tax administrator's argument rests heavily on the assumption that we must rely on federal law which would deny deductibility in the presence of a credit. He urged at oral argument that federal law should be our guide. How-

ever, he has shown no authority, nor have we found any, that requires us to forfeit an independent view of the relationship between Rhode Island and federal revenue laws. The point of the relevant federal code sections and regulations is to prevent a taxpayer from reducing his income by more than the actual value of a particular item of deduction or credit. A taxpayer would not be permitted to take undue advantage of federal law by claiming simultaneously a deduction and a credit for the same item. We do not see any danger of this in the case before us.

[3] Our conclusions are based on § 44-11-11, which defines corporate taxable "net income" to "mean gross income as defined in the federal corporation income tax law applicable to the taxable year," plus or minus certain adjustments. In our view, when the Legislature allowed a corporate taxpayer to use gross income in beginning its computations, it decided to allow the taxpayer to reassess its deductions against income without reference to the federal return. Cases cited by the tax administrator which deny the deduction on similar facts are inapposite to this case. Those cases involve statutes that differ from our own in that they require a corporate taxpayer to begin computing state tax liability from its federal taxable income rather than from its gross income. The result, under those statutes, we believe, is to afford the taxpayer less discretion in computing the state tax than appears to be the case in Rhode Island. By beginning the state tax computation with taxable income, such statutes as are found in the tax administrator's cases appear already to have taken the taxpayer's deductions into account.

For the reasons stated, the petition of George, Inc., is granted. The judgment of the District Court is hereby quashed, and the papers are remanded to the District Court with our decision endorsed thereon.

Amend. 14, § 1 CONSTITUTION OF THE UNITED STATES

§ 1. Citizenship — Privileges and immunities — Due process — Equal protection of laws. — All persons born or naturalized in the United States, and subject to the

jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

INTERNAL REVENUE CODE OF 1939

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(c) TAXES GENERALLY. —

(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except—

(C) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take any extent the benefits of section 131;

SEC. 31 TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax (other than the tax imposed by subchapter E, relating to tax on self-employment income), to the extent provided in section 131.

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

[Sec. 131 (a)]

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102 and except the additional tax imposed for the taxable year under the provisions of section 127 (c) (3) and except the tax imposed under subchapter E and except, with respect to the tax imposed under subchapter D, only to the extent provided in subsection (j), shall be credited with:

(1) CITIZENS AND DOMESTIC CORPORATIONS— In the

case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

INTERNAL REVENUE CODE OF 1954

SEC. 164 TAXES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) State and local general sales taxes.

(5) The windfall profit tax imposed by section 4986.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income).

SEC. 275 CERTAIN TAXES.

(a) GENERAL RULE.—No deduction shall be allowed for the following taxes:

(1) Federal income taxes, including—

(A) the tax imposed by section 3101 (relating to the tax on employees under the Federal Insurance Contributions Act);

(B) the taxes imposed by sections 3201 and 3211 (relating to the taxes on railroad employees and railroad employee representatives); and

(C) the tax withheld at source on wages under section 3402.

(2) Federal war profits and excess profits taxes.

(3) Estate, inheritance, legacy, succession, and gift taxes.

(4) Income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 901 (relating to the foreign tax credit).

SEC. 901 TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) ALLOWANCE OF CREDIT. If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 56 (relating to minimum tax for tax preferences), against the tax imposed for the taxable year under section 72(m)(5)(B) (relating to 10 percent tax on premature distributions to owner-employees), against the tax imposed by section 402(e) (relating to tax on lump sum distributions), against the tax imposed for the taxable year by section 408(f) (relating to additional tax on income from certain retirement accounts), against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1351 (relating to recoveries of foreign expropriation losses), or against the personal holding company tax imposed by section 541.

(b) AMOUNT ALLOWED.—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any posses-

sion of the United States;

SEC. 902. CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION.

(a) TREATMENT OF TAXES PAID BY FOREIGN CORPORATION.— For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid).

(b) FOREIGN SUBSIDIARY OF FIRST AND SECOND FOREIGN CORPORATION. —

(1) ONE TIER.—If the foreign corporation described in subsection (a) (hereinafter in this subsection referred to as the "first foreign corporation") owns 10 percent or more of the voting stock of a second foreign corporation from which it receives dividends in any taxable year, it shall be deemed to be paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such second foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such second foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid).

(2) TWO TIERS.—If such first foreign corporation owns 10 percent or more of the voting stock of a second foreign corporation which, in turn, owns 10 percent or more of the voting stock of a third foreign corporation

from which the second foreign corporation receives dividends in any taxable year, the second foreign corporation shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid by such third foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such third foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes.

(3) VOTING STOCK REQUIREMENT.—For purposes of this subpart—

(A) paragraph (1) shall not apply unless the percentage of voting stock owned by the domestic corporation in the first foreign corporation and the percentage of voting stock owned by the first foreign corporation in the second foreign corporation when multiplied together equal at least 5 percent, and

(B) paragraph (2) shall not apply unless the percentage arrived at for purposes of applying paragraph (1) when multiplied by the percentage of voting stock owned by the second foreign corporation in the third foreign corporation is equal to at least 5 percent.

EXTRACT FROM 28 USC sec. 1257

"Section 1257. Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows: . . . . (3) by writ of certiorari, . . . where any title, right, privilege or immunity is specially set up or claimed under the Constitution, treaties, or statutes of, or commissions held or authority exercised under, the United States."

GENERAL LAWS OF RHODE ISLAND, 1956
(1970 Reenactment)

Volume 7 (1980 Reenactment is identical)

44-11-2. Imposition of tax.—Each corporation shall annually pay the state a tax equal to

(1) eight per cent (8%) of its net income, as defined in § 44-11-11, qualified in § 44-11-12, and apportioned to this state as provided in §§ 44-11-13 through 44-11-15, inclusive, for the taxable year, or

(2) forty cents (40¢) for each one hundred dollars ($100) of the amount of its net worth, as defined in § 44-11-16, as of the last day of the taxable year, whichever amount shall yield the greater tax; except

(a) a corporation shall not pay the amount of the tax as computed on the basis of its net worth under clause (2) of this section but shall pay only the amount of any tax as computed in accordance with clause (1) of this section after deducting from "net income" as used therein fifty per cent (50%) of the excess of capital gains over capital losses realized during the taxable year, if for the taxable year (i) the corporation is engaged in buying, selling, dealing in or holding securities on its own behalf and not as a broker, underwriter or distributor, (ii) its gross receipts derived from such activities during the taxable year amounted to at least ninety per cent (90%) of its total gross receipts derived from all of its activities during such year.

44-11-11. Net income defined.—(a) "Net income" shall mean gross income as defined in the federal corporation income tax law applicable to the taxable year, plus (1) any interest not included in such federal gross income, minus (2) interest on obligations of the United States or its possessions, and other interest exempt from taxation by this state, and minus (3) all items deductible under the federal corporation income tax law applicable to the taxable year, except (i) any specific exemptions, and (ii) the tax imposed by this chapter.

TAX ADMINISTRATOR'S FINAL DECISION

I have read the record of the within case and I approve, adopt and incorporate herein the findings of fact and conclusions of law as made by the hearing officer, Charles E. Goldkamp.

It is my decision that the assessment of additional Rhode Island business corporation taxes in the amount of $2,649.97 is correct.

s/ John H. Norberg
John H. Norberg
Tax Administrator

September 1, 1978

In re: George, Inc.
Rhode Island Business Corporation Tax
1976

JURISDICTION

Pursuant to Chapter 35 of Title 42 of the General Laws of Rhode Island of 1956, as amended, and Rules of Practice and Procedure, a hearing was held on Friday, June 2, 1978, in the Conference Room of the Division of Taxation, 289 Promenade Street, Providence, Rhode Island.

The hearing was held in accordance with the request submitted in the letter dated February 17, 1978.

The main purpose of the hearing was to allow the taxpayer to present evidence and arguments that the corporation was improperly assessed an income tax.

There was a request for an official stenographic transcript of the proceedings.

Taxpayer was represented by William Mullin, CPA, and David A. King, CPA.

STATUTE AT ISSUE

At issue is the following section of the Rhode Island General Laws of Rhode Island of 1956, as amended: Section 44-11-11.

RECORD OF THE CASE

Protest of Assessment, Notice of Hearing, Appointment of Hearing Officer, Tax Administrator's Exhibits A - C, Taxpayer's Exhibit #1, Official Stenographic Transcript.

CONTENTION OF THE TAXPAYER

It is the contention of the taxpayer that foreign taxes for which it chose the federal credit provided in 26 USC §901 are deductible in computing Rhode Island business corporation taxes.

FACTS

1. That the taxpayer, George, Inc. (George), is a Delaware corporation with its principal place of business located at One Weybosset Hill, Providence, Rhode Island.

2. That George is a wholly owned subsidiary of Champlin Jewelry Co., a Rhode Island corporation.

3. That George owns securities of Canadian corporations.

4. That the Canadian securities generate dividends which are subject to Canadian taxes.

5. That under Rhode Island regulations, George is not permitted to file a consolidated Rhode Island business corporation tax return with its parent.

6. That in computing its 1976 Rhode Island business corporation tax liability (corporate income tax), George deducted the Canadian taxes applicable to the Canadian securities.

7. That in computing federal income tax liability for 1976 George chose the federal credit provided in 26 USC §901 for the Canadian taxes.

CONCLUSIONS OF LAW

All statutory references to the General Laws of Rhode Island of 1956, as amended, will be cited as "Section" e.g. Section 44-11-11. All statutory references to 26 USC, the federal internal revenue code, will be cited as "IRC §" e.g. IRC §901. All references to 26 CFR, the code of federal regulations, will be cited as "Treas. Reg. §" e.g. Treas. Reg. §1.901-1.

"Net income" as pertinent to the instant matter is defined in Section 44-11-11(a) as follows:

> "Net income" shall mean gross income as defined in the federal corporation income tax law applicable to the taxable year, . . . minus (3) all items deductible under the federal corporation income tax law applicable to the taxable year, except (i) any specific exemptions, and (ii) the tax imposed by this chapter. (Emphasis supplied.)

Based on the above-quoted statute, George is permitted Rhode Island deductions for only those items deductible for federal purposes for 1976. When a taxpayer chooses the credit for foreign taxes permitted under IRC §901, such taxpayer is not permitted a deduction of such foreign taxes for that year. See Treas. Reg. §1.901-7(c), Treas. Reg. §1.164-2(d), IRC §275(a)(4). As no deduction was allowable for federal purposes, no deduction was allowable for Rhode Island purposes.

RECOMMENDATION

Based on the foregoing, it is the recommendation of the hearing officer that the assessment of additional Rhode Island business corporation taxes set forth in Tax Administrator's Exhibit B be affirmed.

s/ Charles E. Goldkamp
Charles E. Goldkamp
Hearing Officer

September 1, 1978

STATE OF RHODE ISLAND AND
PROVIDENCE PLANTATIONS

PROVIDENCE, Sc DISTRICT COURT
SIXTH DIVISION

GEORGE, INCORPORATED)
)
VS) A. A. 78-253
)
JOHN H. NORBERG)
TAX ADMINISTRATOR)

D E C I S I O N

DEL NERO, J. This matter comes before the Court on an Administrative Appeal from a decision of the Tax Administrator assessing an additional $2,649.97 in corporate income tax against the plaintiff corporation.

A review of the administrative record in this proceeding and the memoranda filed by both parties reveals that there was no question of fact in dispute in this case and the question at issue is principally a question of law. The facts stated quite briefly are that the taxpayer is a wholly owned subsidiary of a Rhode Island corporation bearing the name Champlin Jewelry Company. The taxpayer was created in 1960 in order to segregate the ownership of foreign securities. George, Incorporated is a personal holding company which owns only securities of Canadian corporations. Its sole stockholder is a Rhode Island resident and it provides employment for three Rhode Island residents. During the year 1976, George, Incorporated paid taxes to the Canadian government in the amount of $36,573.25 on its Canadian income. On its federal income tax return, it chose to have the benefits of the foreign tax credit provided by Section 901 of the Internal Revenue Code of 1954. It did not elect to deduct those taxes under Section 164 of the Internal Revenue Code. On its Rhode Island corporate income tax return, it attempted to deduct the taxes paid to the Canadian government because the Rhode Island tax law does not provide for a foreign tax

credit as does the Internal Revenue Code. The Tax Administrator disallowed this deduction on the basis that the taxpayer, having elected to obtain the benefits of the federal foreign tax credit, made the taxes paid to the Canadian Government not deductible for federal income tax purposes because of the provisions of Section 275(a)(4) of the Internal Revenue Code of 1954. Such taxes, therefore, are not within the allowable deductions for Rhode Island corporate income tax purposes. Therein lies the dispute and question of law raised by the parties in this case.

The position of the taxpayer basically is that the law of Rhode Island allows a deduction for all items deductible under the federal corporate income tax law applicable to the taxable year. R.I. General Laws Section 44-11-11(a)(3). The taxpayer says that since foreign taxes are deductible generally and since the intention of the General Assembly was to tax only net income, in this case the foreign taxes should be allowed as a deduction for Rhode Island corporate income tax purposes. Not to allow the deduction in this situation subjects the taxpayer to taxes not only on his net income but also to tax on the Canadian taxes which constitutes double taxation.

The argument of the taxpayer that to not allow the deduction constitutes double taxation is one which this court feels is a bootstraps argument in this situation which does not reach the statutory or constitutional propositions which the taxpayer ascribes to it. The taxpayer misconstrues the meaning of the Statute which is clearly to impose a tax on net income measured with regard to the federal deductions allowable in that particular taxable year. These Canadian taxes were not allowable federal income tax deductions in the year 1976 and not deductible in Rhode Island.

All parties are agreed that if the taxpayer had not elected to choose the benefits of the foreign tax credit, the taxes paid to the Canadian Government would have been deductible both from federal and Rhode Island gross income to determine the taxable income. The tax-

payer had a choice in arranging the transaction in the manner that this transaction was structured. It was the taxpayer who chose the benefits of Section 901 and thus made the Canadian taxes non deductible. The taxpayer having chosen the benefits of Section 901 must also bear its burdens.

The law of Rhode Island is clear that in determining net income for corporate tax purposes, one may deduct "all items deductible under the federal corporate income tax law applicable to the taxable year, except (i) any specific exemptions, (ii.) the tax imposed by . . . (Chapter 44-11 of the General Laws)."

It is clear that foreign taxes for a year in which a taxpayer claims the benefits of Section 901 of the Internal Revenue Code (the foreign tax credit) are not deductible (because of Section 275(a) (4)) under the federal income tax law applicable to the taxable year.

Accordingly, the petition of the taxpayer George, Incorporated is denied and dismissed. In reaching this decision, this Court is not unaware of the fact that as the taxpayer set up the transaction here involved, 91 percent of his gross income went to pay federal, state and Canadian taxes. Neither this Court nor the Tax Administrator can restructure a clear and unambiguous meaning of the law in this situation.

The parties shall within ten days present a proposed form of judgment for entry in accordance with this decision.

STATE OF RHODE ISLAND DISTRICT COURT
PROVIDENCE, Sc

GEORGE, INCORPORATED)
VS) A. A. 78-253
JOHN H. NORBERG)
TAX ADMINISTRATOR)

J U D G M E N T

This cause came on before Mr. Justice Del Nero on administrative appeal, and upon review of the record and memoranda of counsel, and a decision having been ren-

dered, it is

ORDERED AND ADJUDGED

The petition of the taxpayer George, Incorporated is denied and dismissed.

Dated at Providence, Rhode Island this 10th day of October 1979

By Order,
s/ Raymond D. George
Raymond D. George
Chief Clerk

ENTER
s/ Del Nero, J.
Justice

Supreme Court

George, Inc. :
v. : No. 79-425 M.P.
John H. Norberg :
Tax Administrator :

O R D E R

The petition to reargue is denied.

Entered as an order of this court this 20th day of May, 1982.

BY ORDER,
s/ Walter J. Kane
Walter J. Kane
Clerk

GEORGE, INC.

v.

John H. NORBERG, Tax Administrator.

444 ATLANTIC REPORTER, 2d SERIES 868, at 870

For the reasons stated, the petition of George, Inc., is granted. The judgment of the District Court is hereby quashed, and the papers are remanded to the District Court with our decision endorsed thereon.